Impact of Global Financial Crisis on India Collateral Damage and Response

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Challenges for the Asian Economy

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Global Crisis and Emerging Economies

- Emerging economies too hit hard by the crisis – the "Decoupling Theory" did not work
- Reality:
  - Capital flow reversals
  - Sharp widening of spreads
  - Abrupt currency depreciations
- In a crisis of this nature and magnitude, no country is an island.
- Like other emerging economies, India too hit by the crisis

Questions That I Will Address

- Why has India been hit by the crisis?
- How has India been hit by the crisis?
- How have we responded to the challenge?
- What is the outlook for India?

Why Has India Been Hit by the Crisis? (1)

Two Arguments

India should not have been hit because:

1st argument:

- Indian financial sector has no exposure to the tainted assets or stressed institutions.
- Indian financial sector has only limited off-balance sheet activities.

2nd argument:

- India's growth emanates from domestic demand and domestic investment .
- India's exports are less than 15% of GDP.

Why Has India Been Hit by the Crisis? (2)

Response

- More closely integrated with the rest of the world
- Financial integration as deep as trade integration

How Has India Been Hit by the Crisis?(1)

Contagion from outside to India

- Financial channel
- Real Channel
- Confidence Channel

How Has India Been Hit by the Crisis? (2)

(i) Financial Channel

- Drying up of overseas financing
- Capital outflows as part of global deleveraging
- Reserve Bank's intervention in the forex markets

How Has India Been Hit by the Crisis? (3)

(ii) Real Channel

- Slump in demand for exports
- Service exports decelerating
- Remittances from migrant workers slowing

How Has India Been Bit by the Crisis? (4)

(iii) Confidence Channel

- Tightened global liquidity eroded confidence
- This came on top of turn in the credit cycle

How Have We Responded to the Challenge? (1)

RBI's monetary policy response guided by three objectives:

- Ample rupee liquidity
- Comfortable foreign exchange liquidity
- Credit flow to productive sectors

How Have We Responded to the Challenge?(2)

Government's Fiscal stimulus

- Additional capital spending
- Govt.-guaranteed infrastructure spending
- Cuts in indirect taxes
- Expanded guarantee cover for micro & small enterprises

Response to Measures Taken

- Potential liquidity ($75 billion) – Comfortable
- Call money rates within the policy corridor
- Banks have reduced lending rates
- Bank credit has expanded
- But total flow of resources to commercial sector has declined

Evaluating Response to Crisis

- Origins of crisis common
- Evolution of crisis different
  - Advanced economies – financial to real sector
  - Emerging economies – real to financial sector
- Response to crisis – country-specific

Outlook for India (1)

- Economic activity slowing
- Exports declined in Oct-Dec 2008
- Services sector decelerating
- Investment demand on decline
- Corporates margins dented
- Growth moderation steeper than earlier thought

Outlook for India (2)

Several positive features

- Inflation declining
- Lower crude prices will yield fiscal space.
- Current account deficit modest

Outlook for India (3)

Several positive features (contd.)

- Financial markets functioning normally
- Banks safe, sound and well-capitalized
- Comfortable foreign exchange reserves

Outlook for India (4)

Several positive features (contd.)

- ‘Wealth-loss’ effect minimal – consumption demand should hold up
- Agriculture credit not affected
- Social safety net system provides fall back in distress

When the Turn Around Comes

- India growth fundamentals intact
- Growth based on:
    - Growing entrepreneurial spirit
    - Rising productivity
    - Increasing savings
- Benign global environment too helped
- India's recovery will be swift and sharp
- Meanwhile, painful adjustment inevitable
- Challenge – minimise the pain